STATE OF SOUTH CAROLINA

(Caption of Case)

Annual Review of Purchased Gas Adjustment and Gas Purchasing Policies of Piedmont Natural Gas Company, Inc.

BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

COVER SHEET

DOCKET NUMBER: 2011 - 4 - G ___

(Please type or print)

Submitted by:	Scott Tyler	SC Bar Number:	12037
Address:	Moore & Van Allen	Telephone:	704-331-2463
	100 N. Tryon Street, Suite 4700	Fax:	704-378-1963
	Charlotte, NC 28202-4003	Other:	
		Email:	scotttyler@mvalaw.com

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DOCKETING INFORMATION (Check all that apply)

☐ Emergency Relief demanded in petition ☐ Request for item to be placed on Commission's Agenda expeditiously

☐ Other: Prefiled Testimony/Exhibits of Keith P. Maust, Robert L. Thornton, & William C. Williams

INDUSTRY (Check one)	NATURE OF ACTION (Check all that apply)		
☐ Electric	☐ Affidavit	☐ Letter	☐ Request
☐ Electric/Gas	☐ Agreement	☐ Memorandum	☐ Request for Certificatio
☐ Electric/Telecommunications	☐ Answer	☐ Motion	☐ Request for Investigation
☐ Electric/Water	☐ Appellate Review	☐ Objection	☐ Resale Agreement
☐ Electric/Water/Telecom.	☐ Application	☐ Petition	☐ Resale Amendment
☐ Electric/Water/Sewer	☐ Brief	☐ Petition for Reconsideration	☐ Reservation Letter
☒ Gas	☐ Certificate	☐ Petition for Rulemaking	☐ Response
☐ Railroad	☐ Comments	☐ Petition for Rule to Show Cause	☐ Response to Discovery
☐ Sewer	☐ Complaint	☐ Petition to Intervene	☐ Return to Petition
☐ Telecommunications	☐ Consent Order	☐ Petition to Intervene Out of Time	☐ Stipulation
☐ Transportation	☐ Discovery	☒ Prefiled Testimony	☐ Subpoena
☐ Water	☒ Exhibit	☐ Promotion	☐ Tariff
☐ Water/Sewer	☐ Expedited Consideration	☐ Proposed Order	☐ Other:
☐ Administrative Matter	☐ Interconnection Agreement	☐ Protest	
☐ Other:	☐ Interconnection Amendment	☐ Publisher's Affidavit	
	☐ Late-Filed Exhibit	☐ Report	

Before the
Public Service Commission of South Carolina

Docket No. 2011-4-G

Annual Review of Purchased Gas Adjustment and Gas Purchasing Policies
of
Piedmont Natural Gas Company, Inc.

Testimony
of
Keith P. Maust

On Behalf Of
Piedmont Natural Gas Company, Inc.

Piedmont Natural Gas

June 10, 2011

Q. Please state your name and your business address.

A. My name is Keith P. Maust. My business address is 4720 Piedmont Row Drive, Charlotte, North Carolina.

Q. By whom and in what capacity are you employed?

A. I am employed by Piedmont Natural Gas Company, Inc., (Piedmont) as Managing Director, Gas Supply and Scheduling.

Q. Please describe your educational and professional background.

A. I graduated from West Virginia University in 1976 with a Bachelor's Degree in Business Administration. I was employed by Tennessee Gas Pipeline for five years from 1983 to 1988 as an Analyst in the Gas Reserves and Gas Supply departments. I joined Piedmont as a Gas Supply Analyst in July, 1988. I was promoted to Manager of Gas Supply in 1991 and Director of Gas Supply in 1995. In 1996 I was promoted to Director of Gas Supply and Wholesale Marketing. I was promoted to Managing Director, Gas Supply and Scheduling in 2006.

Q. Please describe the scope of your present responsibilities for Piedmont?

A. My current major responsibilities include supervision of long and short-term purchasing and scheduling of gas supply and gas cost management activities and the administration of the Company's Hedging Plan.

Q. Have you previously testified before this Commission or any other regulatory authority?

A. Yes, I have presented testimony beginning in 1997 through 2010 and appeared as a witness before this Commission in the matter of the Commission's annual review of Piedmont's Gas Costs and Purchasing Policies (Dockets No.97-007-G, 98-004-G, 99-004-G, 2000-004-G, 2001-004-G, 2002-004-G, 2003-004-G, 2004-004-G, 2005-005-G, 2006-4-G, 2007-4-G, 2008-4-G, 2009-4-G and 2010-4-G) and in the matter of Piedmont's approved hedging policy (Docket No. 2001-410-G). I have also presented testimony and appeared as a witness before the North Carolina Utilities Commission (NCUC) regarding Piedmont's gas purchasing policies and proposed Hedging Plan and presented testimony before the Tennessee Regulatory Authority (TRA) regarding Tennessee's Incentive Plan Account.

Q. What is the purpose of your testimony in this proceeding?

A. My testimony will describe Piedmont's gas purchasing policies. This testimony is in response to the Commission's directive issued in Order No. 88-294 dated April 6, 1988 requiring ". . . annual public hearings . . . to review the Company's . . . gas purchasing policies" and in response to the Commission's Order establishing pre-filing deadlines in this docket.

Q. What is the period of review in this docket?

A. The review period is April 1, 2010 through March 31, 2011.

Q. Please explain Piedmont's gas purchasing policies.

A. Piedmont has previously utilized and continues to maintain a "best cost" gas purchasing policy. This policy consists of five main components -- the price of the gas, the security of the gas supply, the flexibility of the gas supply, gas deliverability and supplier relations. All of these components are interrelated, and we will continue to weigh the relative importance of each of these factors when developing an overall gas supply portfolio to meet the needs of our customers.

Q. Please describe each of the five components.

A. The "price of the gas" refers to the delivered cost of gas to Piedmont's city gate. In order to properly judge prices at a comparable transaction point, Piedmont evaluates purchase prices at the pipeline city gate points of delivery into Piedmont's distribution facilities. With the unbundling of the interstate pipeline industry, substantial flexibility exists in structuring gas supply arrangements. The majority of Piedmont's supply purchases take place at "pooling points" into the pipeline on which Piedmont holds firm transportation capacity rights. These "pooling point" supply purchases from producers and marketers include the commodity cost of gas at the pooling points and the fuel to be retained by the downstream pipeline transporter. Commodity transportation charges are also assessed separately by pipelines. Any "best cost" analysis that solely considered supply area or "pooling point" cost would fail to recognize the varying cost in fuel and commodity costs associated with transporting gas purchased from different supply area locations to Piedmont's city gate. In the case of "bundled" city gate supply purchases, Piedmont may pay the gas supplier an all-inclusive price that covers the cost of gas, fuel and transportation charges. Of course, peaking and storage services may add additional injection, withdrawal, and related fuel charges to the city gate cost of gas. All of these cost components must be taken into account in evaluating the "price of the gas."

"Security of gas supply" refers to the assurances that the supply of gas will be available when needed. Obviously, it is important to maintain a high level of supply security for Piedmont's firm customers who have no alternate fuel capability. Security of gas supply is less important for our interruptible customers who have access to alternate fuels. In order to reserve firm gas supplies under contract, fixed reservation fees are generally required in addition to the commodity cost of gas. In addition, the geographic source of supply, the nature of the supplier's portfolio of gas supplies and negotiated contract terms must be considered when evaluating the level of supply security. Thus, the security of gas supply is interrelated with the price of gas and the other components of Piedmont's "best cost" purchasing policy.

"Flexibility of gas supply" refers to our ability to adjust the volume of a particular gas supply as operating and market conditions change from time to time. For example, firm heat sensitive customers will vary their consumption depending on the weather conditions in Piedmont's service area. Interruptible customers will vary their level of purchase depending on the price of alternate fuels and the demand for product in their own industry.

Thus, Piedmont must arrange a portfolio of gas supplies and storage service flexible enough to meet the daily and monthly "swings" in the market place. Contractual gas supply "swing rights" are implemented through periodic renominations with gas suppliers and through injections into and withdrawals from storage.

"Gas deliverability" refers to the ability to obtain Piedmont's gas supplies at the city gate through reliable transportation and storage capacity arrangements. The unbundling of the interstate pipeline industry has created a complex system of multiple pipeline services and service combinations. Transportation arrangements can involve intrastate transportation, interstate lateral line and pooling services, multiple interstate pipeline transportation and storage arrangements, and balancing and peaking services. The marketplace for pipeline capacity service is static, with little to no unused capacity available during periods of design temperature conditions. Consequently, it is important that we secure and maintain firm transportation and storage capacity rights to ensure the deliverability of our gas supplies to meet the design day, seasonal, and annual needs of our customers. Of course, pipeline capacity contracts require the payment of fixed demand charges to reserve firm transportation or storage entitlements. Piedmont is active in proceedings at the Federal Energy Regulatory Commission (FERC) not only with respect to the level of pipeline charges under these contracts, but also the tariff terms and conditions that apply to these pipeline services.

"Supplier relations" refers to the dependability, integrity and flexibility of a particular gas supplier. We contract with gas suppliers who have a reputation of honoring their contractual commitments and have proven themselves as reliable suppliers. Conversely, we avoid suppliers which have a reputation of defaulting on contract obligations or who unilaterally interpret contracts to their advantage. We prefer to deal with suppliers who are constantly looking for ways to improve service and offer "win-win" solutions for meeting customer needs.

Q. Please describe the arrangements under which Piedmont purchases gas.

A. Piedmont purchases gas supplies under a diverse portfolio of contractual arrangements with a number of reputable gas producers and marketers. In general, under Piedmont's firm gas supply contracts, Piedmont pays negotiated reservation fees for the right to reserve and call on firm supply service up to a maximum daily contract quantity (nominated either on a monthly or daily basis), with market-based commodity prices tied to indices published in industry trade publications. These firm contracts range in term from one year (or less) to terms extending into 2013. Longer term contracts may provide for periodic reservation fee renegotiations. Some of these contracts are for winter only (peaking or seasonal) service and some provide for 365 day (annual) service. Firm gas supplies are purchased for reliability and security of service and are generally priced on a reservation fee basis according to the amount of nomination flexibility built into the contract (daily swing service generally being more expensive than monthly baseload service). When existing supply contracts expire, requests for proposals are sent to potential suppliers, their responses evaluated, and firm supplies are then contracted from suppliers whose proposals best fulfill Piedmont's "best cost" purchasing policy.

Piedmont also purchases gas supplies in the spot market under contract terms of one month or less. These contracts provide for little or no supply security in that they are interruptible and short term in nature. As a result, Piedmont relies on these contracts primarily for interruptible markets during off-peak periods when spot supplies are more abundant and for supplemental system balancing requirements. Because of the nature of spot contracts, these supplies do not command reservation fees and are priced on a commodity basis, generally by reference to industry index or negotiated prices.

Q. How does the interrelationship of the five factors described above determine the character of the supply and capacity contracts under your "best cost" policy?

A. Under our "best cost" policy, we attempt to secure and maintain a supply portfolio that is in balance with the requirements of our sales markets. Because our firm sales market must have a secure and reliable gas supply, we meet the needs of this market primarily with long-term firm supply and transportation contracts, supplemented by storage and peaking services. The temperature sensitivity of the firm market necessitates that flexibility of supply and storage also be provided. As mentioned earlier, firm supply contracts demand a premium payment, typically in the form of fixed reservation fees. Also, firm supply contracts with flexibility of swing service entitlements will command a higher price than baseload arrangements. Because our interruptible market is more price sensitive and requires less supply security, we supply this market with off-peak firm gas supply and transportation services when the core market demand declines and through the purchase of gas supplies in the spot market.

In short, before entering into any agreement to purchase gas or pipeline capacity, we carefully consider the use for the supply and weigh the five "best cost" factors (price, security, deliverability, flexibility, and supplier relations). Obviously, a great deal of judgement is required when weighing these factors. To help us exercise this judgement, we try to keep informed about all aspects of the natural gas industry. We intervene in all major FERC proceedings involving our pipeline transporters, stay in constant contact with our existing and potential suppliers, monitor gas prices on a real-time basis, subscribe to industry literature, follow supply and demand developments, and attend industry seminars.

Q. What is your greatest challenge in applying your "best cost" gas purchasing policy?

A. Since most major gas supply decisions require a considerable degree of planning and must be made years in advance of service, our greatest challenge is dealing with future uncertainties in a dynamic national and regional energy market. In a perfect world, we would be able to accurately predict our future demand for gas, the future availability and pricing of gas supplies and capacity, and future regulatory policies. Of course, in the real world, we cannot accurately predict any of these factors. Future demand for gas is affected by economic conditions, customer conservation efforts, weather patterns, regulatory policies and industry restructuring in the energy markets. The future availability and pricing of gas supplies will be affected by overall demand, oil and gas exploration and development, pipeline expansion projects, and regulatory policies and approvals.

Q. Please explain the Company's position regarding the current U.S. supply situation.

A. For much of the first decade of this Century, wholesale futures pricing of natural gas reflected by the NYMEX was extremely volatile. Peak pricing for futures contracts occurred in July, 2008 when contracts for gas to be delivered during January, 2009 sold for $14.516 per dekatherm. Due to the significant and largely unexpected quantities of shale gas that have become available to the market in the last several years, the wholesale futures price of natural gas has declined dramatically. It is Piedmont's expectation that some volatility will remain in the wholesale market, particularly related to force majeure type events or significant changes in demand, but that the dramatic swings previously seen in the wholesale futures market are not likely to recur with the same regularity or intensity so long as shale gas supplies remain abundant.

Q. Please explain the factors that the Company evaluates in determining the pricing basis for its gas supply contracts. Please discuss the various pricing alternatives available, such as fixed prices, monthly market indexing and daily spot market pricing and describe how supplier reservation charges and discounts or premiums from market prices enter into the evaluation.

A. The Company has various pricing options available to it when developing its gas supply portfolio. These options include fixed pricing, monthly market indexing and daily spot pricing. Fixed pricing scenarios are addressed in the Company's Hedging Plan, which has been approved by the Commission. The reservation fee the Company pays for each contract in its firm supply portfolio is dependent upon the pricing options chosen and the supply flexibility requirements associated with each contract. Reservation fees are generally lower for base load supplies (purchased at a constant volume for the entire month) and higher if swing service is required. Reservation fees vary depending on the type of swing service being provided. Examples of factors which affect the cost of swing service are: a) the number of days of swing required; b) the volume of swing allowed; c) commodity pricing at first of the month indices versus daily spot pricing; d) first of the month keep whole pricing; e) intraday versus interday swing capabilities; and f) location of the supply being purchased. The Company considers its anticipated load factor and swing requirements under various weather scenarios, measuring the exposure to price fluctuations of the spot market and the factors listed above and makes a "best cost" purchasing decision.

Q. Please describe how the Company determines the daily contract quantity of gas supplies that should be acquired through long-term contracts for the whole year, the full winter season and periods less than a full winter season.

A. The Company will purchase gas supplies on a year around basis to fulfill its firm requirements including storage injections and to minimize supply costs utilized to serve both firm and interruptible markets. Some of these contracts will escalate in volume during shoulder months and the winter period (November through March) as the Company's firm requirements increase due to colder weather, thus sculpting year around contracts to fit seasonal needs. The Company also purchases volumes for the winter period to match its firm transportation capacity entitlements, which also increase during the winter period. Lastly, the Company may purchase short-term city gate peaking supply to fulfill additional firm obligations as the Company experiences peak day firm demand requirements. The Company reviews warm winter weather scenarios to measure its ability to fulfill its contractual purchase commitments with suppliers.

Q. Please explain the provisions in the Company's gas supply contracts that allow or help facilitate future renegotiation efforts if future market conditions offer new opportunities and describe any contractual restraints that prevented the Company from obtaining the full benefit of favorable spot market conditions during the review period.

A. All of the Company's supply contracts have market-based commodity prices tied to indices published in industry trade publications. These commodity pricing provisions allow the Company to obtain the full benefit of market priced gas.

Q. What process does the Company employ in selecting its firm gas suppliers?

A. The Company identifies the volume and type of supply that it needs to fulfill its market requirements and solicits requests for proposals (RFP's) from a list of suppliers that the gas supply department continuously updates as potential suppliers enter and leave the market place. As mentioned earlier, type of supply is classified as baseload or swing and firm or interruptible. Requests for proposals for swing supply may be further categorized into pricing based on first of the month indices, keep whole, or daily market indices. Swing supplies priced at first of the month indices command the highest reservation fees because suppliers incur all the risk associated with market volatility during the delivery period. Keep whole contracts require the Company to reimburse suppliers for the difference between first of the month index prices and lower daily market prices if the Company doesn't take its full contractual volume. Because the Company assumes the volatility risk associated with falling prices, a lower reservation fee is warranted. Lower reservation fees are also associated with swing contracts based upon daily market conditions because both buyer and seller assume the risk of daily market volatility. After forecasting the load factor of each individual contract and evaluating the cost of reservation fees associated with each type of supply and its corresponding bid, the Company makes a "best cost" decision on which type of supply and supplier to fulfill its needs.

Q. Please summarize any supply arrangements entered into by the Company during the review period.

A. During the review period the Company added new seasonal or year around supply utilizing its normal RFP process described earlier.

Q. Please describe the process that Piedmont utilized and the market intelligence evaluated during the review period to determine the prices charged for off-system sales.

A. The process and information used by Piedmont in pricing off-system sales depends upon the term of the sale, the type of sale and prevailing market conditions at the time of the sale. For long-term delivered sales (longer than one month), Piedmont solicits bids from potential buyers and awards volumes based on the bids received. For short-term transactions (daily or monthly) Piedmont will monitor prices and volumes on Intercontinental Exchange (Intercontinental Exchange or "ICE" is an electronic trading platform where potential buyers post bids and potential sellers post offers at various physical locations), talk to various market participants on the telephone or instant messenger and for less liquid trading points, estimate prices based on price relationships with more liquid points. The Company will also evaluate the amount of supply available for sale and weigh that against current market conditions in formulating its sales strategy (i.e., if Piedmont has a large amount of supply to sell on a particular day and determines that market demand is low, the Company will be more aggressive in its sales strategy). The Company incorporates all these factors and then initiates sales via "ICE" or over the telephone or instant messenger.

Q. Did Piedmont make any changes in its gas purchasing policies or practices during the period of review?

A. Piedmont did not implement any changes in its "best cost" gas purchasing policies or practices during the test period.

Q. Did Piedmont's Hedging Plan work properly during the review period?

A. Yes. The Hedging Plan accomplished its goal of providing an insurance policy to reduce gas cost volatility for customers in South Carolina in the event of a gas price fly up.

Q. What were the net economic results of the Hedging Plan during the review period?

A. Piedmont's South Carolina customers incurred a net economic cost of $538,035 as a result of Piedmont's Hedging Plan during the review period. This net economic impact includes expenses incurred in administering the program including commissions, software, subscriptions and data feed.

Q. Given the changed supply-demand environment, has the Company made any changes to its Hedging Plan?

A. The Company made dramatic changes to its Hedging Plan prior to this year's review period by reducing its hedging volume and time horizon as well as limiting its hedging tools to the purchase of calls. By only purchasing calls the Company limits loss exposure to the initial cost of the calls and allows the customer full participation of the benefits of a falling market while providing some price protection if market prices fly up as they did in 2008. The Company believes that the increased gas supply deliverability caused primarily by the increase in shale related natural gas production warrants a reduction in the level of protection necessary to protect the Company's customers from today's reduced market price volatility. Although natural gas shale production has some environmental issues – primarily the use of fracing fluids and the use and disposal of large amounts of water necessary to effectuate production, those issues have been successfully dealt with for several years. The Company will continue to closely monitor the gas supply – demand picture and make changes it deems necessary to its hedging program.

Q. Please describe how compliance with the Hedging Plan is monitored.

A. Currently, the Gas Accounting, Finance, and Corporate Compliance areas perform ongoing activities to monitor compliance with the Plan. In addition, on a bi-monthly basis the Energy Price Risk Management Committee (EPRMC) monitors compliance to the Plan, as well as considers and approve any changes to the Plan, as mentioned above. Periodic internal audits have and will be performed to ensure controls continue to be adequate and function as management intends.

Q. Have there been any deviations from the Hedging Plan during the review period?

A. There were no deviations from the Plan during the review period.

Q. Did the Company take any other action to reduce price volatility for its customers?

A. The Company continues to utilize storage as a physical hedge to stabilize cost. The Company's Equal Payment Plan and use of the PGA benchmark price and deferred cost accounting also allowed for a smoothing effect on gas price volatility.

Q. What are some of the other steps Piedmont has taken to manage its gas costs consistent with its "best cost" policy during the review period?

A. During the past year, Piedmont has taken the following additional steps to manage its gas costs, consistent with its "best cost" policy:

(1) Piedmont has, as more fully described in Mr. Williams testimony, actively participated in proceedings before the FERC and other regulatory agencies that could reasonably be expected to affect Piedmont's rates and services;

(2) Piedmont has utilized the flexibility available within its supply and capacity contracts to purchase and dispatch gas, release capacity and initiate secondary marketing sales in the most cost effective manner, resulting in South Carolina capacity release and secondary market sales credits of $6,422,549, an increase of $1,407,838 over the prior year;

(3) Piedmont has actively promoted more efficient peak day use of natural gas and load growth from "year-around" markets in order to improve the Company's load factor and reduce average unit costs.

Q. Please summarize your testimony.

A. Piedmont's "best cost" purchasing policy provides the Company with a secure, reasonably priced supply of gas to meet the requirements of its customers. This policy and the Company's practice under this policy have been reviewed and found prudent on all occasions in South Carolina and the other state jurisdictions in which we operate. Although we believe our policies and procedures are reasonable, we are cognizant of the fact that the natural gas industry is rapidly changing, and we are constantly monitoring our policies and procedures to keep up with, and even anticipate, these changing conditions. We have and will continue to meet with the Commission and ORS Staff to review current regulations and tariffs and explore possible changes that will better serve our natural gas customers in the future. We are satisfied that our existing policies and procedures are prudent and that they have produced and will continue to produce adequate amounts of reasonably priced gas for our customers.

Q. Does this conclude your testimony?

A. Yes.